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C O N F I D E N T I A L SECTION 01 OF 03 ULAANBAATAR 000591

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TREASURY PASS USED TO WORLD BANK AND IMF
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STATE PASS EXIM AND OPIC

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TAGS: [EFIN](#) [EAID](#) [PREL](#) [PGOV](#) [SOCI](#) [MG](#)
SUBJECT: IMF PUTS NEW PROGRAM NEGOTIATIONS WITH MONGOLIA ON
HOLD

Classified By: DCM - Brian L. Goldbeck. Reasons: 1.5 (B) and (D).

1. (C/NF) SUMMARY: Local IMF Resident Representative Jang (strictly protect) told Emboffs August 3 that the IMF had decided to postpone further discussion with the Government of Mongolia (GOM) over a new IMF program to replace its long-lapsed program. Jang was now informing key donors and would advise the GOM within a day or so. The IMF,s management made this decision because of the widening gap between what the current government said it would do and what actually transpired; in other words, the GOM lacked credibility. That said, Jang saw some limited improvements in Bank of Mongolia (BOM) supervision, a positive trend, and the IMF plans to provide several technical assistance missions. He thought new program negotiations might resume in December. END SUMMARY.

2. (C/NF) Newly-arrived USAID Director Barry Primm, accompanied by DCM and USAID Senior Program Manager, paid a courtesy call August 3 on IMF Resident Representative Byung Kyoon Jang. Jang (strictly protect) began the discussion by advising that the IMF had decided to postpone further discussions with Government of Mongolia (GOM) on a new IMF program, noting he planned to so advise the GOM in the next day or so of the IMF,s decision. Jang said he was now in the process of alerting a few key donors of this decision. Thus the IMF,s August mission would center around the usual Article IV consultations and not/not include negotiations for a new program to succeed the previous program which lapsed in July 2005.

IMF CONCERNED ABOUT BUDGET DEFICIT
AND SUSTAINABILITY

3. (C/NF) Jang was critical of the Embassy,s recent press release (which congratulated the GOM for its passage of key tax reforms) for insufficient focus on fiscal sustainability, although he noted the release did flag the need to maintain

budget discipline and fiscal neutrality. He added that the new Mongolian tax laws themselves were not yet available in their final form so it is difficult to develop a full assessment of the financial impact of the new laws. Thus the size of the potential deficit is still in question, but he expected the budget deficit to be smaller than the initial forecasts and within the manageable range. He too was concerned about the political trend toward increased social spending. Jang said the IMF is generally opposed to increases in import tariffs as contrary to promoting trade. (NOTE: The Embassy's press release was designed to inoculate the USG from a potential GOM attempt to scape-goat its budget deficits and failure to meet IMF conditions by laying the blame on "tax reform advice provided by the U.S.," when in fact the USAID advisory team only provided value-neutral analytical and "modeling" assistance to the GOM and SGH decision-makers, who made the tax decisions.)

CREDIBILITY AND CLARITY GAPS

14. (C/NF) Offering his analysis of the IMF's decision to postpone additional new program negotiations, Jang said the IMF's management had made this decision much earlier largely because the GOM lacked credibility.8 Basically, there is a gap between the GOM's statements or promises and what it actually delivers -- the end results, Jang said. For example, statements made by the Minister of Finance during the spring IMF/World Bank meetings about the GOM's actions were not realized as the State Great Hural (Mongolia's Parliament) adopted different paths on budget expenditures. The GOM said the VAT would not be touched yet it was reduced, and there was no mention at all of possible increases in import tariffs. The absence of clarity on these and other

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issues, coupled with the GOM's declining credibility, had "triggered8 the IMF's decision to postpone further new program discussions until perhaps December or so, Jang said, provided the GOM's autumn budget situation is reasonable. (NOTE: During a separate meeting with TDY Treasury Rep, Jang emphasized that the Finance Minister is well-intentioned and has a clear understanding of the need for fiscal discipline, but he exerts no control over Parliament, so the credibility problem is structural in nature. Jang also said he does not envision fiscal policy discipline taking hold in Parliament unless a new Prime Minister with stronger leadership skills and solid grasp of the issues were appointed.)

TA MISSIONS PLANNED

15. (C/NF) Meanwhile the IMF had decided to provide several technical assistance missions to provide: 1) legal assistance to the tax department, 2) support to flesh out implementation of taxation related to the new mining law, 3) operation of the new development8 fund (previously known as the stability fund8 stocked with proceeds from the newly-enacted gold/copper windfall profits tax), 4) a review of the Bank of Mongolia's gold purchase/sales operations, 5) banking supervision, and, 6) statistics. Jang said it was highly unusual for any country to have more than perhaps two such missions and the large number of missions reflects the IMF's commitment to Mongolia and its future.

POSITIVE TREND AT BOM INCREASES IMF,S COMFORT LEVEL

16. (C/NF) Asked whether the IMF's earlier concerns about the Bank of Mongolia had been resolved, Jang said a May IMF supervision mission had looked at governance issues and taken note of steps being taken to remedy the IMF's concerns. For example, the BOM had begun the process of identifying and interviewing possible non-executive members for the BOM's board. A new central bank law will be put before the SGH in August or September. Jang also noted an improvement in BOM

senior management,s attitude, which coupled with increased IMF technical assistance (meaning increased access and knowledge of BOM activities), had given the IMF greater comfort.

COMMENT

17. (C/NF) The IMF,s doubts about the GOM,s credibility and ability to deliver are not surprising, and are shared by post. Indeed, the IMF's decision to postpone further negotiations with this government are probably warranted, given the frequent rumors that it may/may fall at any time. Post agrees there have been a few small but promising signs regarding BOM supervision, but it,s too early to tell if those are real or substantive. Jang also surmised that current BOM Governor Chuluunbat might be reappointed to a second term, concerns about corruption, etc. notwithstanding.

The IMF local mission had earlier expressed concern to Embassy officials about the nature of the tax reform advice being given by the USAID advisory team to the GOM and SGH, especially the assertion by some GOM and SGH officials that the USAID team was urging a reduction in the VAT tax, a measure that the IMF has strongly discouraged. Subsequent meetings of Embassy officers, USAID advisory team leaders, IMF and GOM officials seemed to clear the air: the USAID advisory team's role was merely to crunch numbers and run a computer model that provided analysis of the impact of various tax proposals. While the IMF,s postponement decision was taken before much earlier and for other reasons, it would appear that the Embassy's press release provides convenient cover for the IMF,s decision and explains its initial pique. (The Embassy,s press release can be found at

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<http://mongolia.usembassy.gov/7/19/06.html>.) END COMMENT.
SLUTZ